Brascan NY: Merchant redux

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Canada's Brascan Corporation has completed a $500 million bridge financing for a hydroelectric portfolio in the bank market. The deal would be notable as one of the few opportunities to come the way of US lenders this year. That it comes to market without a single contract or parental guarantee attached is all the more surprising.

But the financing does not herald a wholesale recovery in the US power market, much less a recovery in wholesale power prices. The outlines of this transaction belie a deal for a sponsor with a very specific set of financial requirements, on a set of assets that do not frequently come up for sale. As such, the financing says a lot about how Brascan is steadily building up a portfolio that straddles the US and Canada, but less about what more conventional sponsors might expect.

The Brascan New York Hydro portfolio consists of 71 small hydroelectric facilities with a capacity of 674MW, and a 105MW gas/oil-fired cogeneration plant, all located in New York State. With the purchase, Brascan immediately becomes the largest hydro producer in the state. The plants' previous owner was Reliant Energy, previously Reliant Resources, which acquired the plants when it bought Orion Power in 2001.

The Orion assets, which included the New York plants, as well as some Midwestern capacity, were the subject of $1.58 billion in debt. This debt was refinanced in March 2003 after a fraught set of negotiations between Reliant and its lenders. At the time, the lenders to the New York assets were induced to support the structurally separate Midwestern assets by cross-collateralising them with the New York plants, which were performing much better.

But a recovery in sponsor interest in power assets encouraged Reliant to look at selling them, and it retained Goldman Sachs, which previously was a part-owner of Orion Power, to run an auction. The owner and its adviser issued a first call for expressions of interest early in 2004, and received binding offers in May. Brascan reached an initial agreement to buy the plants for $900 million on 18 May.

Brascan's main interests are in real estate, asset management and power generation. It now has an aggregate 2,600MW in generating capacity, of which 90% is hydroelectric. Brascan, based in Toronto, and traded in New York and Toronto, looks to make a 20% cash return on equity. Its generation portfolio is spread over Ontario, Quebec, New England, New York, Louisiana and British Columbia.

It has had a far degree of success in raising long-term finance against its assets, both in Canadian and US dollars. According to Kelly Marshall, senior vice-president at Brascan's corporate finance department, "we raised C$384 million ($303 million) in 20-year notes [Great Lakes Power], C$175 million in 17-year notes [the Mississagi Power Trust], and $125 million, in 10-year US dollar debt". Brascan's read is that the long-dated market will be available once it can establish an operating history for the assets.

The biggest challenge in running the plants will be coping with their lack of contracts. A legacy power purchase agreement with Niagara Mohawk, which sold the hydro plants to Orion in 1999 for $425 million, expired in September. Brascan, which has a power trading team based in Gatineau, Quebec, will now try to optimise the assets with a mix of short- and medium-term contracts and spot sales.

In theory, this situation would not appeal to potential lenders. As one source close to the arrangers put it: "it might have eight letters, but merchant is still basically a four-letter word." In their favour, however, is the familiarity with the credit that comes from repeated financings and refinancings. Aside from the Orion and reliant deals, some of the plants are understood to be early Qualifying Facility financings.

Moreover, the portfolio has a rating, and a high one at that. The Dominion Bond Rating Service (DBRS), and independent Canadian ratings agency, has assigned the three separate parts of the portfolio an A (low) rating. DBRS has worked with Brascan on the previous placements, and prides itself on an extensive experience with hydro assets. It now has Nationally Recognized Statistical Rating Organization (NRSRO) status in the US, but it has yet to be tested how familiar US-based dollar accounts will be with its work.

As such, the sponsor has divided the assets up into three portfolios - Lake Ontario, St Lawrence River and Hudson River. The three could all be financed and operated separately, and an outline structure has already been established. The three are not qualitatively different - all carry A (low) ratings - but operate in three distinct footprints. They have been carved up so that Brascan can adjust the size of a capital markets refinancing to accommodate demand, without altering leverage. Ontario is slated to raise $148 million, St Lawrence $191 million, and Hudson $161 million. The 105MW Carr Station, bought by Orion from USGen for $17 million in 1999, has not been included in the calculations, and does not at present have any economic value.

The bridge loan, led by ABN Amro, Citigroup and Scotia Capital, has a two-year maturity and is priced at a competitive 100bp over the 90-day Libor. The leads closed the financing on 28 September, and are currently syndicating the debt. They are understood to have received commitments from co-arrangers, but not to have completed allocations. The bond issue will take place over the next 12 to 18 months, depending on market conditions.

So, while lenders will probably not be holding the debt for a long period of time, the deal should give them an idea of how power prices in the northeastern US are faring. Moreover, it also demonstrates that there are sponsors such as Brascan that look for assets to generate stable cashflows, and benefit from them. Marshall says that Brascan was inundated with pitches from Term B arrangers, but that the debt was too expensive to use as a bridge, but too short-term (at seven years) to be a viable long-term solution. Given that in September Brascan also raised $77 million in 4.4% 5-year notes for its BBB-rated Lake Superior cogen plant, the decision looks sensible.

Brascan Power New York
Status: Bridge financing closed 28 September 2004, in syndication
Size: $874 million
Location: New York State
Description: bridge acquisition financing for 779MW predominantly hydro portfolio
Sponsor: Brascan Power
Debt: $500 million
Arrangers: ABN Amro, Citigroup, Scotia Capital
Tenor: 2 years
Margin: 100bp over Libor
Market consultant: Pace
Engineer: MWH
Sponsor counsel: Weil Gotschal & Manges
Lender counsel: Milbank Tweed Hadley & McCloy
Insurance: AON